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LE ROI EST MORT, VIVE LE ROI! On NAFTA and USMCA

Summary:

The present paper is an essay that presents the author's brief contribution to the discussion on the North American trade agreement, formerly known as NAFTA. It is written from an independent perspective and involves no political affiliation.

NAFTA, which during its almost 25 years of existence, proved a successful mechanism of trade growth, came under attack by President Trump who judged it detrimental to the U.S. economy and threatened to dismantle it altogether. He subsequently retreated from his initial position and let NAFTA, now known as USMCA or the U.S.-Mexico-Canada trade agreement, survive the crisis with some lesser changes. However, the recent loss of the Conservative majority in the lower chamber of Congress, may render the President's position with respect to economic policies more vulnerable in view of the majority for the Democrats. The new situation in the Congress may have a direct impact on USMCA as well. At the completion of the 20-odd-year period of its existence the North American Free Trade Agreement (NAFTA) had to be renegotiated, especially amidst President Trump's repeated vows to dismantle it on the grounds of its detrimental impact on the American economy. The present paper is looking at this renegotiating process. It is describing its most salient points, including a concise description of what is going to change and what will remain as before. It points out to the advantages and disadvantages of what is now referred to as NAFTA 2.0 or USMECA (The US-Mexico-Canada trade agreement).

Key words:

NAFTA Agreement, NAFTA 2.0, conflict of interest, country position, advantages and disadvantages, free trade, U.S., Canada, Mexico, tariffs, economic growth

Introduction

"Le roi est mort, vive le roi!" This age-old exclamation perfectly fits into the melodrama surrounding the renegotiation of the North-American Free Trade Agreement (NAFTA), following President Donald Trump's vow to dismantle, or at least completely restructure, the 20-odd – year – old agreement, which he was finding detrimental to America's interests. After the initial vow to pursue his objective, President Trump had somewhat mitigated his stance and let NAFTA survive the crisis albeit under a different name: United States-Mexico-Canada, or USMCA, trade agreement, which is also referred to as NAFTA 2.0.

Yet NAFTA has proven extremely successful over a period of over 24 years of its existence. Trade among the three partners quadrupled and this greatly contributed to economic growth of the member countries. That NAFTA has been asymmetric in certain areas is beyond doubt, but overall the advantages of the agreement cannot be denied. It is now a \$21 trillion-dollar regional market, accounting for only 7% of the world's population but generating 28% of global GDP¹.

The present paper is an attempt to put NAFTA and its successor - USMCA into some perspective; what has actually changed and what remains as before. Plus ça change...

What was NAFTA hitherto fore?

NAFTA took effect on January 1, 1994 under President Bill Clinton, who pushed it through the US Congress. However, the ground for the pact was laid much earlier by Ronald Reagan and the Canadian

¹Th. F. McLarty, J. D. Negroponte, A NAFTA without Canada? Unthinkable. Detroit Free Press of September 16, 2018.

Prime Minister Brian Mulroney in Quebec City (1988), when the two leaders signed an agreement known as FTA or CUFTA². President George H.W. Bush signed NAFTA on Oct. 7, 1992, setting the stage for the congressional approval of the agreement that came into effect on January 1, 1994.

NAFTA has been successful right from the outset, but it was criticized from all sides for its failure to address, let alone solve, some critical issues, such as, for example, immigration, protection of the environment, cultural heritage, etc. However, the critics of NAFTA were all too easily disregarding the fact that it was just a trade agreement aimed, first and foremost, at reducing and then eliminating most of the tariffs and other obstacles to trade³. In the latter field the gains from NAFTA are undeniable. Intra-NAFTA trade grew exponentially, and the agreement quickly became the largest trade block in the world.

The initial structure of the NAFTA agreement which, incidentally, had been modified several times during the quarter century of its existence⁴ included the following components⁵.

PREAMBLE

PART ONE: GENERAL PART

PART TWO: TRADE IN GOODS

PART THREE: TECHNICAL BARRIERS TO TRADE

PART FOUR: GOVERNMENT PROCUREMENT

PART FIVE: INVESTMENT, SERVICES AND RELATED MATTERS

PART SIX: INTELLECTUAL PROPERTY

PART SEVEN: ADMINISTRATIVE AND INSTITUTIONAL PROVISIONS

PART EIGHT: OTHER PROVISIONS

ANNEXES

On the whole the Agreement was composed of 22 chapters and 7 annexes.

It is noteworthy that NAFTA had been managed by a reduced number of bureaucrats whose number was a fraction of what the European Union represented. The Secretariat that included three national sections: the U.S. Section, Canadian Section and Mexican Section, permanently employed only a handful of people. That might have been a partial explanation of the success of NAFTA.

However, the truth may not be that clear-cut. NAFTA benefited not only Mexico, but also, if not principally, the American consumers who were purchasing cheaper goods now available throughout North America. Had it not been for NAFTA, the place of the Mexican exports to the U.S. would have been taken by China or other countries⁶.

The staunchest critics of NAFTA wield the loss of jobs argument rather uncritically, adding fuel to a strongly politicized polemic aimed principally at scaring the populace at large who does not perceive the issue in global terms. An average American is averse to any transfer of his/her workplace to another country, and pays little or no attention to genuine economic argumentation. True, certain jobs might have gone south of the border, but scores of other jobs had been created, a large portion of which were high-paid jobs in the service sector, such as consultancy, design, financial sector, health care and the like. While

² The Canada-U.S. Free Trade Agreement. Synopsis. Department of Foreign Affairs. Ottawa, December 1987. Vol.I-XII.

³ Anderson S., Cavanagh J., Lessons of European Integration for the Americas. Institute for Policy Studies. Washington. D.C., February 2004.

⁴ The Canada-U.S.: op. cit.

⁵ Ibidem.

⁶ NAFTA, 20 Years Later: Do the Benefits Outweigh the Costs? Wharton@Knowledge. University of Pennsylvania, February 14, 2014.

no one can precisely quantify the gains of NAFTA against the costs in-as-much as jobs are concerned, the macroeconomic indicators, such as for instance the overall growth of trade, low unemployment (at the time of writing this article- November 2018- the U.S. unemployment rate stood at 3.6%) and other indicators cannot be denied.

A report by the U.S. Chamber of Commerce⁷ had been unequivocal. It stipulates among other things that since NAFTA entered into force in 1994, trade with Canada and Mexico has nearly quadrupled to \$1.2 trillion annually, and the two countries buy more than one-third of U.S. merchandise exports. Trade with Canada and Mexico supports nearly 14 million U.S. jobs, and nearly 5 million of these jobs are supported by the increase in trade generated by NAFTA, according to a comprehensive economic study commissioned by the U.S. Chamber of Commerce⁸.

But Robert Scott⁹ is unconvinced and claims that the Department's data is skewed. He puts it in very straightforward terms: *"The U.S. economy has grown in the past 20 years despite NAFTA, not because of it"*, arguing that the claims by the Chamber of Commerce are misleading and the loss of the U.S. jobs to Mexico had been irreversible.

It would be hard to prove Robert Scott right or wrong in a way that would leave no doubt in either. It is true that some jobs in the U.S. went to Mexican companies but the question remains: what would happen to these jobs had there been no free trade? At 40\$/h or more of labour cost, a U.S. car manufacturer would not be competitive; neither on the internal market nor in export markets. U.S. consumer is the ultimate winner, after all.

In order to tackle the question of whether NAFTA was beneficial to the three partners of the agreement one should refer to chart 1 below. It is a succinct presentation of pros and cons of NAFTA for the member countries.

1. Chart of NAFTA Pros and Cons

| List | Pros | Cons | Worth It? |
|----------------------------|---|--|-----------|
| Trade | Increased. | | Yes |
| Jobs | Created 5 million U.S. jobs. | 682,900 U.S. manufacturing jobs lost in some states. | Yes |
| Wages | Average wages increased. | Remaining U.S. factories suppressed wages. | Yes |
| Immigration | | Forced jobless Mexicans to cross the border illegally. | No |
| Workers | | U.S. unions lost leverage. Mexican workers were exploited. | No |
| Environment | | Canada exploited shale fields. Mexican environment deteriorated. | No |
| Oil | Costs less in the United States. | Improved Mexican economy. | Yes |
| Food | U.S. costs lower | Mexican farmers went out of business. | No |
| Services | U.S. finance and health care exports increased. | Put Mexican companies out of business. | Yes |
| FDI | Increased. | None. | Yes |
| Government Spending | More competitive bidding on government contracts. | | Yes |

Source: K. Amadeo, Why NAFTA's Six Advantages Outweigh Its Six Disadvantages. Updated October 02, 2018.

⁷ NAFTA Triumphant: Assessing Two Decades of Gains in Trade, Growth and Jobs of October 27, 2015.

⁸ Ibidem.

⁹ NAFTA 20 years, op. cit.

Some comments on the contents of the chart above are worthwhile. While the figures we quote are known, they have the credit of detailing the issues, including those which may be controversial. All the figures presented below have been derived from K. Amadeo¹⁰.

Basically there are **six advantages** of NAFTA for the member countries:

- (1) The quasi-total elimination of tariffs has boosted the trade; it stood at some \$ 1.14 trillion a year and quadrupled since the inception of the agreement. Every economics student knows that where there is trade there is growth. While the trade balances of the member states may well be asymmetric, but this is the result of the low competitiveness of the U.S. economy which finds it hard to compete on the international markets. Moreover, the U.S. trade deficit with Mexico is a fraction of its deficit with China and the latter might have been much bigger had there not been NAFTA.

The comparative advantage of intra-NAFTA trade stems, among other things, from geography and lower transportation costs compared with the Far East countries. These lower transportation costs are the reason why the economies of the NAFTA member states are so complementary to each other. No wonder Mexico has taken over from Japan her role of the main supplier for the U.S. automotive market, while Canada is the major car parts supplier. To claim that Mexico has taken so many jobs from the U.S. manufacturing industry, and principally from its automotive sector, may appear tantamount to hypocrisy if this issue is analysed in isolation from the other macroeconomic factors. Between 1993, the year before NAFTA went into effect, and 2016, U.S. agricultural exports to Canada and Mexico rose by more than 400%, from \$8.9 billion to \$38.1 billion, according to a *Washington Post* report. Mexico and Canada are now the most important overseas markets for U.S.-grown produce including corn and soybeans, apples and high-fructose corn syrup, the report said.

- (2) NAFTA, according to K. Amadeo¹¹, contributed to increased trade and a greater trade induced increased economic growth. He claims this growth was 0.5% higher on an annual basis. Three industries have benefited from this growth: agriculture, automotive sector and service sector, and in particular financial and health services. This stands in contrast with the view of R. Scott that economic growth in the U.S. occurred not thanks to NAFTA but despite it.
- (3) Stronger economic growth created jobs. U.S. exports to Mexico and Canada led to the creation of almost 5 million new American jobs. During the first four years of NAFTA's existence (1994–1998), the U.S. manufacturing industry sector created 800,000 jobs.
- (4) Foreign direct investment (FDI) more than tripled its volume. The U.S. businesses invested \$452 billion in the other two countries, while the Canadian and Mexican companies invested \$240.2 billion in the United States. That helped U.S. manufacturing, insurance, and banking companies.
- (5) NAFTA lowered prices. U.S. oil imports from Mexico cost less, not only because NAFTA eliminated tariffs, but also because of lower shipping costs. The same relates to imports from Canadian oil sands. Combined, these factors reduced America's reliance on oil from the very volatile Middle East oil fields. Low-cost oil reduces gasoline prices, which in turn reduces transportation cost for other economic sectors. As a result, consumers in all three countries enjoy lower food prices.
- (6) NAFTA helped with government spending across the board, because each nation's government contracts became available to suppliers throughout NAFTA. That helped to increase competition and to reduce costs.

¹⁰ K. Amadeo, Why NAFTA's Six Advantages Outweigh Its Six Disadvantages. Updated October 02, 2018.

¹¹ Ibidem.

But NAFTA also had its *negative sides*. These according to K. Amadeo could be summarized as follows¹²:

- (1) NAFTA has led to the loss of 500,000-750,000 U.S. jobs. Most were in the manufacturing industries in California, New York, Michigan, and Texas. Many manufacturing companies moved to Mexico because of the cheaper labour there. The automotive, textile, computer, and electrical appliance industries were the most affected ones.
- (2) Job migration kept a lid on wage increases. Companies threatened to move to Mexico to keep workers from joining unions. Without the unions, workers were losing their bargaining power. This strategy was very successful and became standard operating procedure for companies. Between 1993 and 1995, half of all companies used it. By 1999, that rate had grown to 65 percent.
- (3) NAFTA put Mexican farmers out of business. It allowed U.S. government-subsidized farm products into Mexico. Local farmers could not compete with the subsidized prices of imported produce. As a result, 1.3 million farmers were put out of business, according to the Economic Policy Institute. It forced unemployed farmers to cross the border illegally to find work. In 1995, there were 2.9 million Mexicans living in the United States illegally. It increased to 4.5 million in 2000, most likely due to NAFTA. The recession drove that figure to 6.9 million in 2007. In 2014, it fell to 5.8 million, roughly double where it was before NAFTA¹³.
- (4) Unemployed Mexican farmers went to work in substandard conditions in the maquiladora system. Maquiladora designates United States-owned companies who employ Mexican workers near the border. They cheaply assemble goods for export back into the United States. The program expanded to employ 30 percent of Mexico's labour force.
- (5) U.S. companies contributed to the degradation of the Mexican environment to keep costs low. Agribusiness in Mexico used more fertilizers and other chemicals. The result was \$36 billion more per year in pollution costs. Rural farmers were forced into marginal land to stay in business. They cut down 630,000 hectares of forests per year. That deforestation contributes to global warming.
- (6) NAFTA allowed Mexican trucks access into the United States. Mexican trucks are not of the same safety standards as American trucks. Congress neither legislated this nor put the rules into effect.

The above review of pros and cons of NAFTA, despite its simplified and succinct form, provides an objective insight into the problem. One could only add that some of the negative sides of NAFTA are the result of a limited nature of the agreement which focuses mostly on economic issues. By no means can it be compared to the highly regulated European Union, which fact will always contribute to the controversy around NAFTA and its successor- USMCA.

From NAFTA to USMCA

After months of negotiation and the impasse relating to the possible exclusion of Canada from the deal, pushed forward by President D. Trump, on September 30th 2018 a renegotiated agreement between the U.S., Mexico and Canada, now known as USMCA, was signed.

To some observers it is a new type of a free trade agreement; to others little has changed, let alone giving President Trump the feeling of having the upper hand in some areas. Needless to say the new agreement will take time to pass through all the legislatures in due form.

¹² Ibidem.

¹³ NAFTA's Impact on the U.S. Economy: What Are the Facts? Economic Policy Institute Sep 06, 2016.

The most important changes between the old NAFTA and USMCA relate to several main areas¹⁴:

- International settlement dispute: A system that allows NAFTA countries to rely on an independent body to resolve disputes will remain intact. Canada on its part had insisted on keeping this provision, known as Chapter 19.
- Dairy: One of the main areas of contention that from the outset of negotiations affected the U.S. and Canada's positions. President Trump was accusing Canada of unfair trade practices and extremely high import duties levied by Canada on imported U.S. dairy products.

In 2016, Canadian farmers received an average price of C\$0.79 a litre for milk, compared with C\$0.49 on average for US farmers¹⁵.

United States will be allowed to increase dairy exports into Canada, a win for Mr. Trump, who had insisted on greater access for United States dairy farmers. It is noteworthy that this issue was one of the main areas of disagreement between U.S. and Canada which feared that cheaper agriculture products from U.S. would destroy Canadian dairy industry. The strongest opposition came from Quebec where dairy farmers survive thanks to quotas that keep high prices of dairy products. Obviously that hurts the consumers who have to pay more for these products as would be the case with imported goods. It remains to be seen how the new arrangements will actually work. Already there are critical voices against imported dairy U.S. products which are considered of a lower quality compared to domestic production. But President Trump had a very limited room for maneuver in this respect if one remembers that in 2017 US farmers dumped almost 100m gallons (close to a half billion litres) of surplus milk.

- Automobiles. The new agreement requires a higher percentage of a car to be manufactured in North America (75% as compared to 62.5% under the old NAFTA) to qualify for zero tariffs. For the first time, the deal requires that a percentage of any vehicle that qualifies for zero tariffs must be manufactured in a factory where the average production wage is at least \$16 an hour. That provision will hurt the Mexican automotive plants, the few of which can pay such wages to their workers.
- Tariffs — steel and aluminum tariffs levied by U.S. remain in place on Canada and Mexico, pending further negotiations. Canada and Mexico secure at least a partial exemption from any potential future American tariffs on automobiles.

The battle of NAFTA – who is the winner?

It is perhaps too early to pick up the winners and losers in what one could colloquially term "a battle of NAFTA". Despite the grim prospects for the renewed agreement at the start of negotiations earlier this year, especially with President Trump's hardly veiled threats to scrap it, NAFTA survived in an almost unscathed form. This can be a good lesson for the others; how to eat the cake and still have it. Canada and Mexico preserved their roles in the Agreement, at the price of certain concessions, of course, and President Trump could also claim a victory. But the essence of the deal remained basically intact, despite an odd new name which few people will retain at the first attempt.

NAFTA survived because it well served its purpose despite open hostility of its adversaries and many unsolved problems as well as its asymmetric nature. It helped economic growth through increased trade and made good use of comparative advantages. Whatever its new name will be; NAFTA 2.0 or USMCA, it will probably be around for years to come. To put it simply; NAFTA survived because it serves well the consumers of North America.

Yet there still remain uncertainties surrounding the new NAFTA, or USMCA. One of the most important ones relates to the legislative process, especially in the U.S. President Trump will no longer enjoy the majority in the lower house of Congress having lost it to Democrats in the mid-term elections of November 6, 2018. It is no secret that the Democrat-dominated House of Representative will not endorse many of Mr. Trump's initiatives. And NAFTA will be in the centre of the congressional debate.

¹⁴ Ch. Riley, Trump decision to kill TPP leaves door open to China. January 24, 2017.

¹⁵ J. Barber, Why Canadian milk infuriates Donald Trump. The Guardian, June 9, 2018.

Some conclusions

There was a point of time when many observers thought President Trump would deliver on his electoral campaign promise to demolish NAFTA¹⁶.

Never before was this threat closer to becoming reality than at the time when he pushed for a bilateral pact with Mexico in late summer of 2018. Combined with Prime Minister Trudeau's staunch opposition to concede on several points¹⁷, and in particular on trade in dairy products regardless how insignificant in numeric terms it was, the threat for Canada of being left out was very real.

Yet common sense prevailed and NAFTA is still there. No matter how much criticism it will draw from all the corners, it will continue. Of many advantages it has, keeping away China's further expansion into North America, and the U.S. in particular, is of great significance. It will also provide a workable alternative to other trade pacts, such as for instance the Trans-Pacific deal, from which the U.S. had withdrawn at President Trump's insistence¹⁸.

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LE ROI EST MORT, VIVE LE ROI! O porozumieniach NAFTA i USMCA

Streszczenie:

Z chwilą wygaśnięcia ponad 20-letniego okresu obowiązywania porozumienia NAFTA zaistniała konieczność renegotjacji jego postanowień, szczególnie w świetle powtarzanych wielokrotnie gróźb Prezydenta Donalda Trumpa unieważnienia go jako układu szkodzącego interesom amerykańskiej gospodarki. Niniejszy artykuł zwięźle charakteryzuje proces renegotjacji, wskazując na najbardziej istotne elementy porozumienia, z uwzględnieniem najważniejszych zmian jakie wprowadza NAFTA 2.0, nazywana również porozumieniem handlowym USA, Meksyku i Kanady. Prezentowany artykuł przedstawiony w formie eseju, odzwierciedla wyłącznie osobiste opinie autora.

Słowa kluczowe:

Umowa NAFTA, NAFTA 2.0, konflikt interesów, pozycja kraju, zalety i wady umów międzynarodowych, wolny handel, USA, Kanada, Meksyk, taryfy, wzrost gospodarczy

¹⁶ P. Donolo, NAFTA is dead and Canada should move on. The Globe and Mail. June 1, 2018.

¹⁷ A Blatchford, Trudeau Says 'No NAFTA Deal Is Better Than A Bad NAFTA Deal'. Canadian Press, August 2018.

¹⁸ Ch. Riley, January 24, 2017.